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United States Senate

COMMITTEE ON SMALL BUSINESS

WASHINGTON, DC 20510-6350

April 19, 1999

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The Honorable Aida Alvarez
Administrator
U.S. Small Business Administration
409 Third Street, S.W.
Washington, D.C. 20416

Dear Administrator Alvarez:

On March 16, I requested an explanation as to why the Small Business Administration (SBA/Agency) failed to report to Congress as required under sections 213 and 223 of the Small Business Regulatory Enforcement Fairness Act of 1996 (Act or SBREFA) (Title II of P.L. 104-121). My letter also asked SBA to report to Congress on its implementation of sections 213 and 223 of SBREFA, which require agencies to provide informal compliance assistance and penalty reductions/waivers to small entities. On March 31, 1999, I received a reply from SBA's General Counsel Michael D. Schattman. Unfortunately, SBA's response was inadequate and raises additional concerns regarding SBA's understanding of and compliance with the Act. In preparing this letter, I consulted with the Congressional Research Service and the Senate Legislative Counsel, and they concurred with my analysis and conclusion that SBA's explanation for its noncompliance is inconsistent with the statute on its face, a legal analysis of the statute, and the intent of Congress as documented in the legislative history.

In SBA's letter, Mr. Schattman asserts that SBA did not need to report to Congress because SBA is not a regulatory agency or, at least, not the type of regulatory agency SBA believes was covered by sections 213 and 223. The rationale behind this strained, interpretation appears to be that SBA is not covered by sections 213 and 223 because: (1) SBA's programs "aid, counsel and protect small business;" (2) SBA does not "impose penalties for regulatory violations"; and (3) SBA allegedly does not "force small businesses to comply with laws and regulations that require them to conduct their businesses in a certain way." I strongly differ with the basis for SBA's rationale.

First of all, sections 213 and 223 invoke the definition of "agency" found in section 551 of title 5, U.S. Code. SBA is not expressly or implicitly excluded from this definition. SBA's attempt to excuse its noncompliance by claiming not to be a "regulatory agency" also fails because the term "regulatory agency" is again based on the definition of "agency" found in section 551 of title 5, U.S. Code, which pertains to administrative procedures and rulemaking.

In general, an agency is a regulatory agency if it has statutory authority to issue rules and enforce compliance with them. SBA is, therefore, a regulatory agency. SBA

issues regulations that govern the participation of small businesses, small governments, and small not-for-profits in the programs it administers. For instance, SBA issues regulations that determine which small businesses qualify as a small disadvantaged business (SDB), a HUBZONE small business concern, or a 7(a) lender. SBA audits compliance with and enforces the requirements of these and other regulations. If a small business is not in compliance with the regulations, SBA has the authority to remove a small business from the list of approved SDBs or HUBZONE small business concerns. SBA can disqualify a financial institution from eligibility as a 7(a) lender or a certified development company under section 504 of the Small Business Investment Act. Consequently, SBA's strained interpretation is not supported in law or fact.

The statement that "SBA does not believe the SBREFA reports were required" only makes sense if two points are assumed correct: (1) that sections 213 and 223 apply only to agencies that impose monetary penalties or fines; and (2) SBA does not impose monetary penalties or fine. While I might concede that section 223 speaks to penalties and fines, section 213 is not limited to compliance assistance related to regulations that carry penalties or fines. SBA's argument is further flawed because not only does SBA's enforcement authority have financial implications for small businesses, but SBA has the authority to impose monetary penalties and Mr. Schattman's letter lists four such instances. SBA appears to have gotten carried away with its post hoc analysis of why it did not comply with these sections and their respective reporting requirements. As the Chairman of the Committee that authorizes SBA's programs, I cannot agree with the statement that "[i]n no circumstances can SBA regulate, control or penalize a small business in the conduct of its enterprise." This statement does not square with SBA's statutory authority. For instance, section 687 of title 15, U.S. Code, authorizes SBA "to prescribe regulations governing the operation of small business investment companies, and to carry out the provisions of this Act" SBA's claim is also contradicted by its inclusion in the November 9, 1998-edition of Unified Agenda of Regulatory and Deregulatory Actions and the publication of SBA's regulatory plan, outlining the Agency's regulatory priorities, and SBA's semiannual regulatory agenda. It is clear that SBA must be enforcing the regulations it promulgates.

In addition, Mr. Schattman's letter lists four instances where SBA can impose monetary penalties on Small Business Investment Centers (SBICs) or individuals obtaining disaster loans. This fact alone appears to discredit the assertion that SBA is not covered by sections 213 and 223. SBA's argument is further undermined by the fact that many SBICs meet SBA's definition of a small business and a small business concern can be a borrower under the disaster loan program. Consequently, we need look no further than SBA's own letter to identify situations that trigger SBA's obligation to comply with sections 213 and 223. Ironically, SBA's authority to enforce its regulations and impose penalties is by no means limited to these four situations.

While I believe SBA's narrow definition of what constitutes a regulatory agency is without merit, even conceding this constrained definition for argument's sake, SBA's letter contradicts itself further. In the letter, the Agency confirms it is covered by section 222, which created the Small Business and Agriculture *Regulatory Enforcement* Ombudsman and Small Business *Regulatory Fairness* Boards. (emphasis added.) The Ombudsman listed SBA as a covered agency in its reports covering 1997 and 1998, and Mr. Schattman's letter notes that SBA gladly accepts credit given it by the SBA-appointed Ombudsman. This appears to conflict with SBA's assertion that it does not regulate small businesses. In fact, in the Ombudsman's 1997 report, SBA is the subject of two complaints from small businesses that "involved enforcement or compliance activity undertaken by a federal regulatory agency with regard to a small business." When the SBA-appointed Ombudsman provided SBA with a copy of the draft report for review, SBA wrote back stating it had no comment on the report. In its letter regarding the next year's draft report, SBA alleged that it was not a regulatory agency; however, in that same letter, SBA says that it will give small businesses notice of their right to comment to the Ombudsman when "we engage in enforcement procedures." The letter also references SBA's "enforcement and compliance activities." Again, I fail to see how SBA can argue that it is covered under section 222 and not sections 213 and 223.

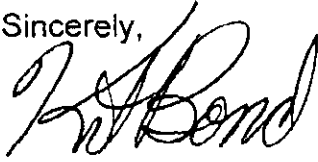
Mr. Schattman's letter failed to mention that numerous small businesses complained to the Ombudsman about SBA's enforcement actions. In fact, the Ombudsman's recent report states that SBA was mentioned in 18 written comments and by 16 people that testified before the Enforcement Ombudsman and Fairness Boards. While some of these complaints may not fall within the Ombudsman's authority, they would seem to imply that SBA's rules and regulations do indeed affect the operations of small businesses. As an example, one small business complained about SBA's denial of a guaranteed loan. In response, SBA informed the company why the "good cause" waiver of the 7(a) loan program's "prior loss rule" did not apply. SBA's own corrective action, informing the District Offices of the procedures to follow, further suggests that the requirements of section 213 and 223 are applicable to SBA.

In addition, Mr. Schattman wrote that "SBREFA only addresses enforcement proceedings" Quite to the contrary, the Act amended chapter 6 of title 5, U.S. Code (commonly known as the Regulatory Flexibility Act) to address explicitly rulemaking activities affecting small entities. In fact, SBA's Office of Advocacy, which is referenced in the letter, is actively involved in the Small Business Advocacy Review Panels created under the Act and is exercising its authority to file amicus briefs in cases initiated by small entities aggrieved by agency noncompliance with the requirements of the Regulatory Flexibility Act. While improving fairness toward small entities during agency enforcement actions is an important part of the Act, the law also addresses agency rulemaking and informal compliance assistance with statutes and agency regulations.

In conclusion, there is nothing in Mr. Schattman's letter that relieves SBA of its obligation to comply with sections 213 and 223. Moreover, there is nothing in the law that allows SBA to forego the requirement to report to Congress on its implementation of these sections. While SBA may not be a regulatory agency of the magnitude of the Environmental Protection Agency or the Occupational Safety and Health Administration, the scope of SBA's activities, its programs and rulemaking activities are consistent with the definition of a regulatory agency. The simple fact that SBA has the authority to issue regulations that affect small entities — positively or negatively — triggers the need to comply with the Act. Furthermore, the Act provides agencies with broad discretion to implement the general requirements of these sections in accordance with the agency's underlying statutes and programs.

It would be an oversight if I did not express my disappointment with SBA. Indeed, I would have expected SBA to lead the charge to comply with this law, which was enacted in great part to implement recommendations from the 1995 White House Conference on Small Business. However, it appears that rather than engaging its attorneys in an effort to comply with the law, SBA instead asked them to devise a rationale to justify noncompliance. This is unacceptable. Consequently, I request that SBA immediately implement programs to provide compliance assistance to small entities and to offer penalty reductions, or waivers, where appropriate, and keep this Committee apprised of your efforts. I look forward to receiving a response by 3:00, April 29, 1999, detailing the steps you will take to bring SBA into compliance with SBREFA.

Should you need additional information, please contact me or Suey Howe, the Committee's Regulatory Counsel, at 224-5175.

Sincerely,

Christopher S. Bond
Chairman